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The Expanding European Union
Tax Implications for Utah Companies

Steve Cullimore

Areas of Concern or Opportunity

- Indirect Tax
  - Customs
  - Value Added Tax
- Direct Tax
  - Transfer Pricing
  - Tax Effective Supply Chain Management

1 May 2004 – The BIG BANG

- The European Commission has indicated that all 10 Accession Countries have indirect tax regimes closely aligned to that of the EU (although each has requested some transitional arrangements).

The new EU is ready for you…

…are you ready for the new 25-member EU?

Customs and Duty Rates

On 1 May 2004…

- Customs borders are eliminated
- Duty rates in the ten Accession Countries will be harmonized with EU duty rates
- EU free-trade agreements will become effective in Accession Countries
- Any bilateral or unilateral agreements become void in Accession Countries

Key Questions

- Do you do business in the Accession Countries? If so…
  - Do your products and services reflect pricing consistent with new duty and VAT regimes?
  - Do you know the ramifications of switching from an export/import regime to a system of free movement of goods?
  - Are you prepared for new customs procedures and relief schemes?
  - Have you assessed how this new system will impact your competitiveness, marketing, and distribution strategy?
  - Are your financial systems prepared for the change?
  - Are you up to speed on new compliance and audit procedures?

Common Customs Tariff Duty Rates

Sample Basket of Finished Products

	Coffee	Flavored Water	Footwear	Shampoo	Mobile Phones	Music CDs	TVs	Cars
CZ	1%	22%	8.2%	6.5%	0%	1.3%	13.2%	17.1%
HU	42.5%	34%	8.9%	15%	15%	5%	10%	13-25%
PO	15%	30%	12%	9%	0%	12%	21%	35%
EU	7.5%	9.6%	17%	0%	0%	3.5%	14%	10%

Example

- Sample basket of goods
  - Average duty rate in Accession Countries is 16%
  - EU duty rate is 7.7%
    - Assuming monthly imports into Accession Countries of $15m
    - Duty difference $1.25m

Companies must proactively assess impact of new duty rates and either speed up or delay shipments if possible

Customs Strategy

- Assess the cost-effectiveness of existing sourcing, manufacturing, and distribution arrangements
  - Determine pre- and post-accession duty rates to and from Accession Countries
  - Assess materiality and plan how and which imports/exports to accelerate and which to delay

This is a one-time opportunity – don't miss out!

Value Added Tax Strategy

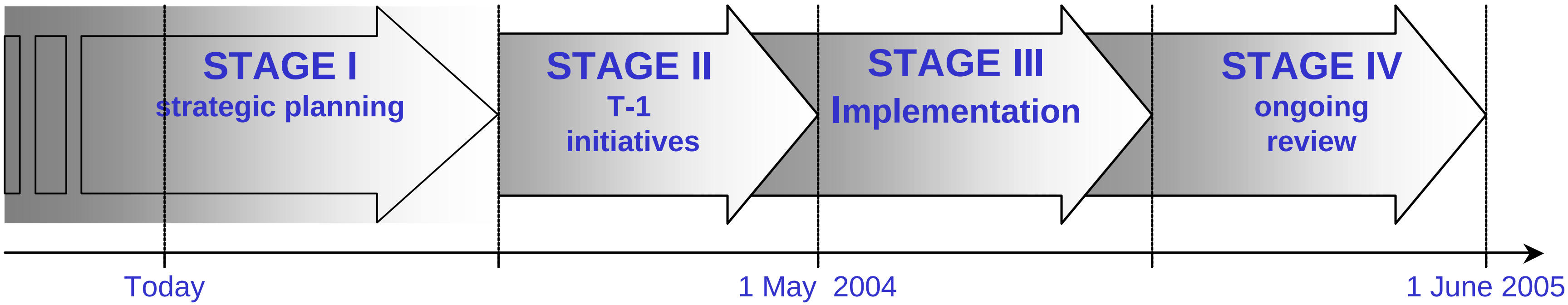
- Companies must ensure compliance mechanisms are in place
  - Transport documents
    - You are primarily responsible when goods cross a new “borderless” border
  - Obtain VAT registration numbers
  - Submission of EC sales lists
  - Intrastat reporting (declaration of cross border transactions)
  - Rate changes

Less border controls means more customs and VAT audits!

Timeline for Action

Phase	Period	Activity
1. Before accession	Now	▪ Build internal awareness regarding impact of EU accession on day-to-day business ▪ Analyse discrepancies ▪ Analyse new reporting requirements (procedures, documents, reports, software, etc.) ▪ Analyse tax savings (differences in tax rates, pre-accession preferences, one-time savings) ▪ Start process of checking customer VAT numbers
2. Before accession	Until 30th April 2004	▪ Prepare and implement new taxation regulations ▪ Develop and implement new reporting and invoicing systems ▪ Develop procedures for clearing intra-community transactions
3. Accession	Just before and after 1st May 2004	▪ Continuously monitor changes ▪ Monitor transitional issues
4. After accession	After 1st May 2004	▪ Regular monitor new internal procedures in the first period after accession

Detailed Plan – Indirect Taxes



	Stage I	Stage II	Stage III	Stage IV
CUSTOMS	• Duty Concessions • Abolition of border control • Major change in tariffs • Trade agreements – redundant v new v modified • Preference/Quotas	• Impact on existing economic procedures • Potential classification mismatches • Maximize use of old tariff, where beneficial	• Manage any remaining trade barriers • Review compliance • Challenge interpretation based on practices and case-law in the EU	• Continuous review
VAT	• VAT registrations - new v. unnecessary existing • VAT refunds: shift to 8th directive rules • Intrastat/VIES – compliance decisions • Compliance outsourcing decisions	Benefit from transition in the following areas: • Reverse charge and acquisition VAT • Review marketing policies • Review irrecoverable VAT position • Compliance: system preparation and testing	• Review compliance: reporting, invoicing, books • Monitor new law interpretation and best practices	• Continuous review

Direct Tax

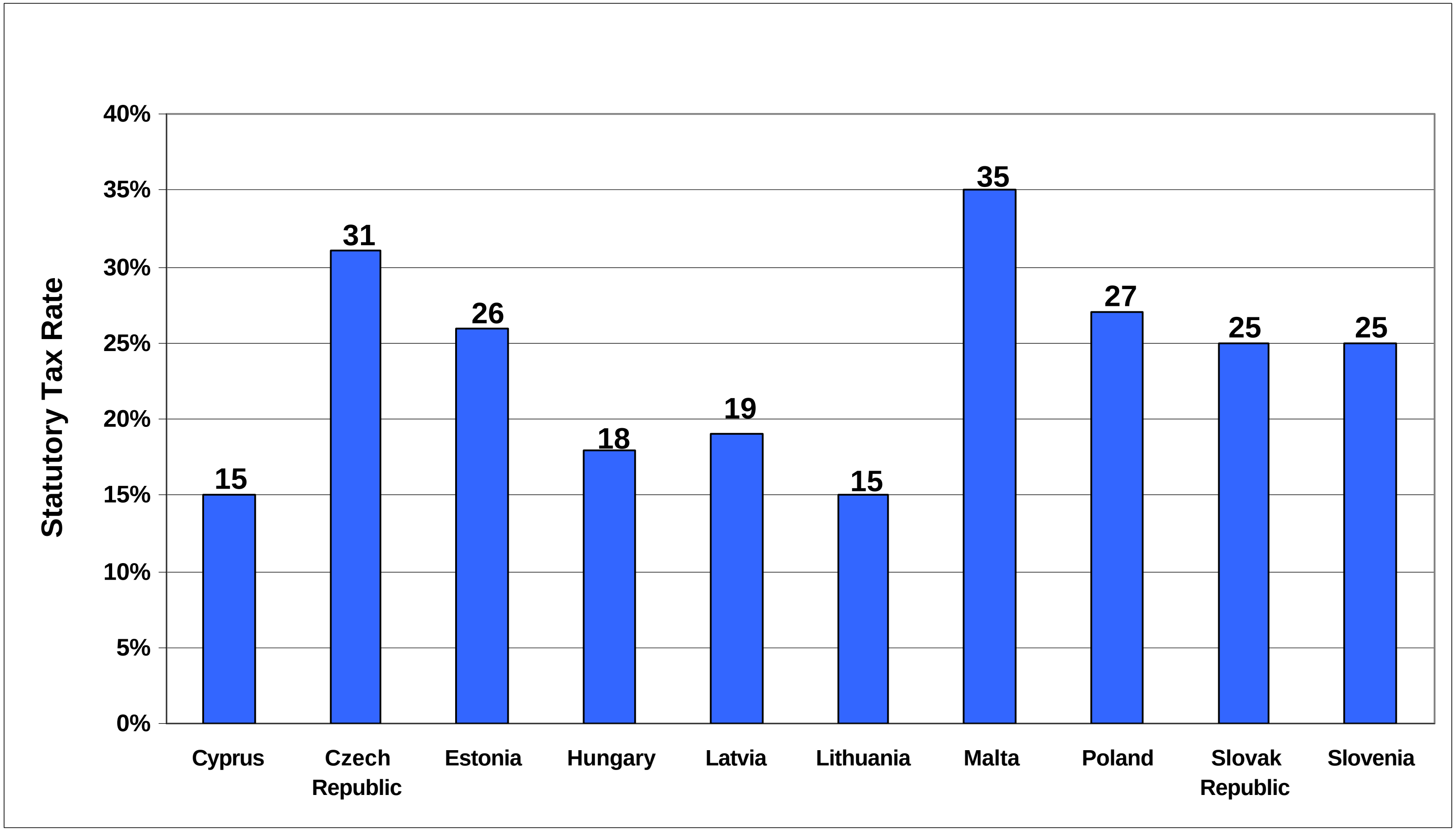
"*The lack of tax harmonization is a serious threat to efficient operation of the Internal Market*" (European Commission)

- EC proposes common consolidated corporate tax base (not tax rate harmonization)
- Reduce tax compliance costs by providing cross-border tax relief and simplifying the complexities associated with transfer pricing

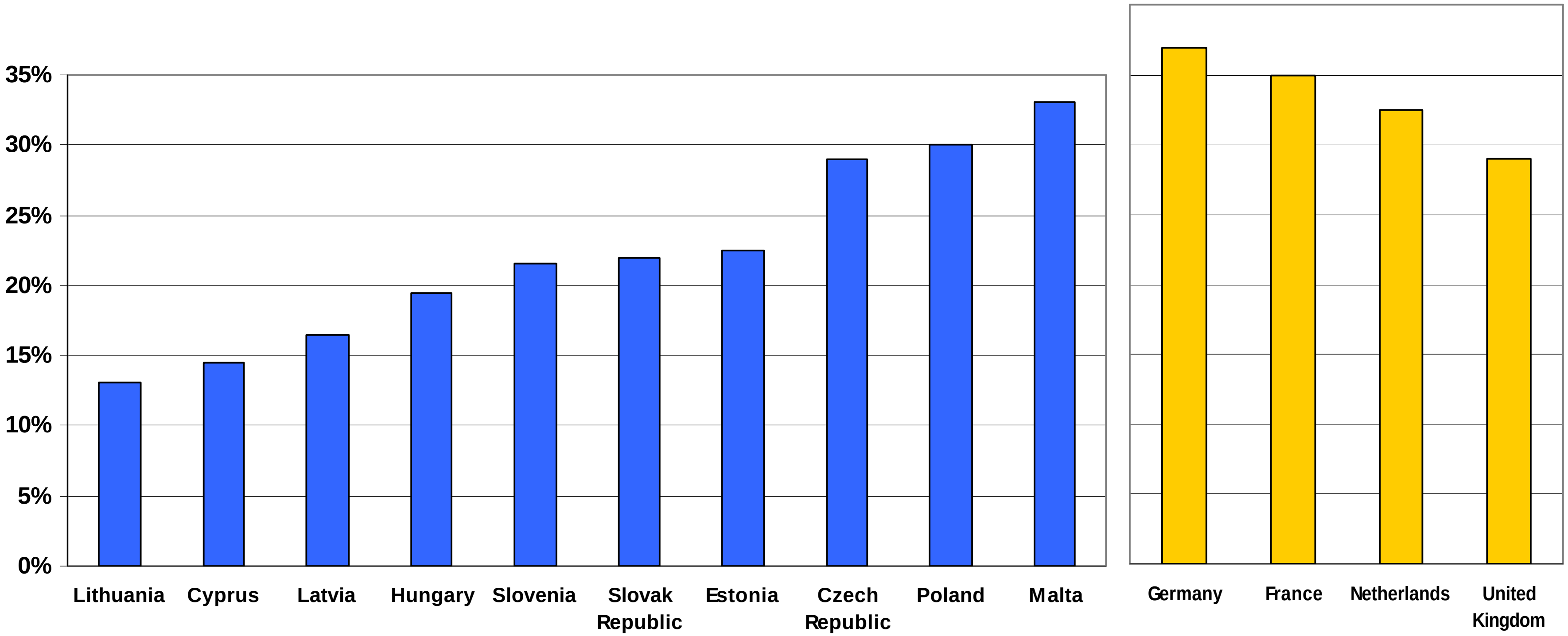
- In general, corporate taxation follows international standards
  - Resident corporations taxed on worldwide income
  - Real-estate tax is the only additional tax levied in most new member states
  - Local profit taxes and other "non-profit" taxes excepted

- On average, new member states offer lower tax rates than current EU members.
  - Cyprus is lowest at 15%
  - Malta is highest at 35%
  - Average is 23.6%

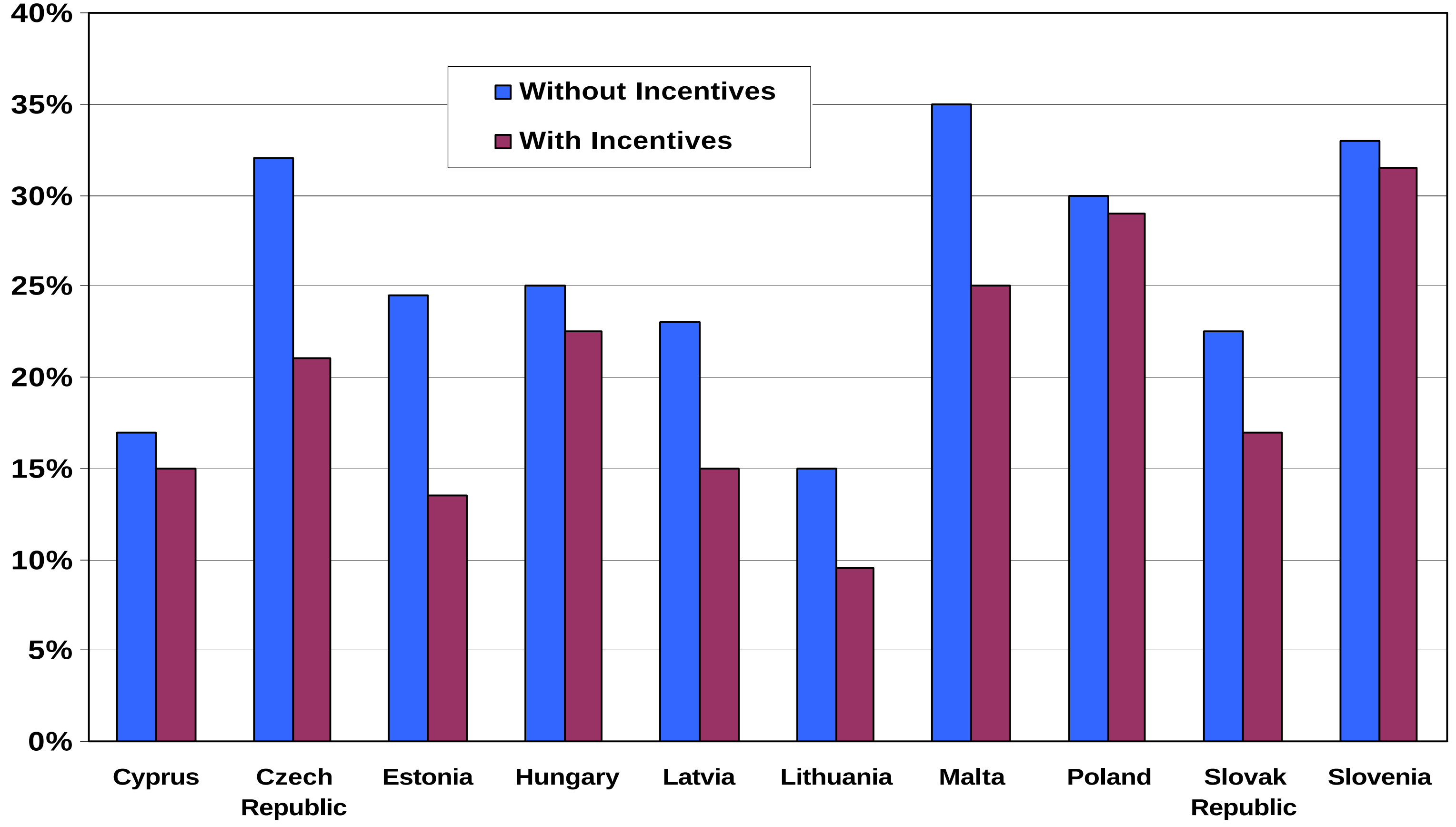
Corp Tax Rates in New Member States



Effective Tax Rate Comparison



Impact of Incentives on Effective Tax Rates



Prospective Tax Changes

- Tax incentives are in conflict with European Law because they distort competition.
- Tax-system reforms have been announced in several countries to compensate for the likely loss of many incentives.

Country	Current Rate	Reduced Rate
Czech Republic	31%	24%
Hungary	18%	12%
Latvia	19%	15%
Poland	27%	19%
Slovak Republic	25%	19%

Bottom line: New member states will become even more attractive to foreign investment as the playing field becomes more familiar and the rules are simplified

Transfer Pricing Rule of Thumb

- Any cross-border transaction with a related party must be priced at “arm’s-length”.
  - Sale of products
  - License or use of an intangible (trademark, process, know-how, formula
  - Provision of service
  - Inter-company financing

Transfer Pricing Scope

- Compliance
  - Companies must demonstrate and document that their inter-company pricing is the same as between unrelated parties
- Controversy
  - Tax authorities have the power to adjust and impute profits in order to reflect arm's-length pricing
  - Penalties and interest are applied
- Planning and Design
  - Proactively using transfer pricing as the basis for profit maximization

Economics of Transfer Pricing

- Across an organization, profits belong in the legal entities where value is created
- Value is created in the following ways
  - Performance of key functions
  - Ownership of key assets (tangible and intangible)
  - Entrepreneurship and the bearing of associated risk
- Profit can be optimized and cash flow freed up when valuable functions, assets, and risks can be moved and/or documented to reside in tax favorable jurisdictions

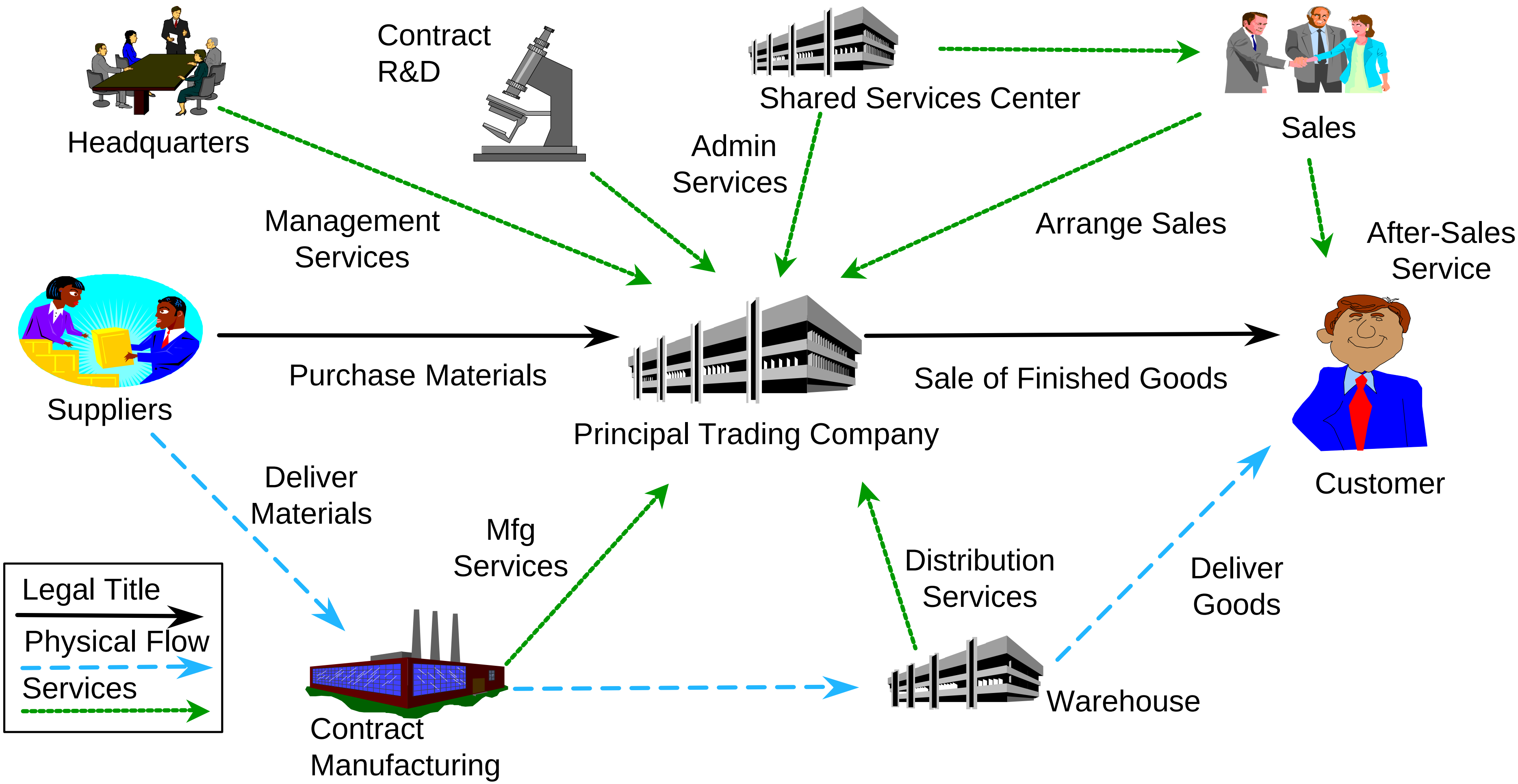
Tax Effective Supply Chain Management

- Principal trading company is established in low-tax jurisdiction
  - Responsibility for functions, assets, and risks is transferred:
    - Purchase raw materials
    - Order management
    - Forecasting
    - Supply/demand planning
    - Capacity planning
    - Demand resource planning
    - Inventory deployment
    - Ownership of intangibles
    - Marketing strategy
    - Supplier selection
- Existing manufacturing operations may be converted into contract manufacturers
  - Income taxes in manufacturing location minimized
- Local distributors perform sales and marketing functions only
  - Since commercial risk is with low-tax trading company, distributors' margin is low ("responsibility" has been shifted to Principal)

Common Features of TESCM Structures

Sourcing	Manufacturing	Sales	Distribution	Administration
Full centralized purchasing	Contract Manufacturing	Limited-risk distributor	Centralized importation	Shared services center
Purchase commissionaire	Consignment Manufacturing	Commissionaire	Centralized warehousing	
Flash-title purchase company	Contract R&D	Sales rep/agent		
Purchasing agent	Sub-contracting	Marketing representative		
Vendor consignment		Regional trading companies		
		Customer consignment		
		Leasing, repair, and installation		

TESCM Operating Model



TESCM in Central and Eastern Europe (CEE)

- Legal and logistical barriers (e.g., customs borders and tariffs) are now gone
- Indirect-tax systems are now mostly in line with the EU
- The benefit of having a separate system based on tax holidays and incentives is going away
- CEE markets are ever expanding and becoming modernized – many are well developed (the trend continues with renewed speed)
- EU tax solutions can now be expanded to include Accession Countries

When should I consider TESCM?

- High value of cross-border movements of goods and services
- High growth rate
- Use or creation of high-value intangibles
- Changes in the physical flow of goods
- Supply-chain improvement initiatives underway
  - Centralization of inventory management, procurement, supplier or client management
- Major acquisition requiring the integration of operations
- New market entry is planned
- Implementation of enterprise-wide information system
- High effective tax rate relative to competitors

Shared-Service Centres in CEE

- Typical functions
  - Finance and accounting
  - HR, payroll, recruiting
  - Tax and legal
  - Marketing
- Location savings for CEE shared-service centres
  - Lower wages and fixed costs
  - Lower overall tax rates
  - Access to W. European-language skill sets

Contact Details

VAT and Customs

Howard Lambert 408-947-6717
howard.lambert@ey.com

Transfer Pricing and Supply Chain

Steve Cullimore 703-772-4288
steve.cullimore@ey.com